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SUBJECT: THE NEVER-ENDING STORY OF THE BAKU NEC

Classified By: Charge Donald Lu for reasons 1.4 (b, d).

¶1. (C) SUMMARY: The history of Embassy and OBO efforts to secure property for a New Embassy Compound (NEC) reads like a Greek tragedy. It is a story complete with unfilled promises, betrayal within families, and political intrigues. Over the course of the past nine years, we have many times been close to a breakthrough. We may again be at one of those periods, with President Ilham Aliyev's personal intervention on June 1 to suggest new formulas for breaking the longstanding logjam on lease payments. Embassy Baku thanks OBO for its patience and determination in managing this long saga. More will be required. In the short-term, we recommend that OBO prepare a property acquisition/legal team to hold face-to-face negotiations with the Azerbaijanis to work through the President's new suggestions on lease payment details. END SUMMARY.

Where are We Now?

¶2. (U) On March 7, 2008, the Baku City Mayor and Ambassador Derse signed a lease for 198 years at the rate of one dollar per annum. Unfortunately, the lease can only come into force with the delivery of a diplomatic note indicating that the lease has received the required bureaucratic approvals (Parliamentary endorsement and Presidential confirmation).

¶3. (C) So why can't they get the approvals? The President decided subsequently that he will not take the lease to the Parliament. We believe that this is partially motivated by difficult land negotiations with other countries, including Iran from which they are reclaiming the land currently used by the Iranian cultural center. Instead, the government now insists the USG try to find a way to comply with existing laws requiring the payment of a minimum lease rate as established annually by the Cabinet of Ministers. We have repeatedly explained that because of the Anti-deficiency Act, we cannot commit to the payment of a unbounded variable lease rate. Although the existing 1999 Bilateral Agreement on Diplomatic and Consular Property Issues between the U.S. and Azerbaijan allows a lump sum payment, the Azerbaijani government now refuses to implement the terms of the agreement, reiterating the desire to have the NEC lease comply as closely as possible with local law.

¶4. (C) On June 1, President Aliyev told visiting Special Envoy Richard Morningstar that he was committed to concluding the last details related to the transfer of land for the NEC. Without apparent consultation with his advisors, he proposed that we consider an arrangement whereby we pay the current year's lease rate for ten years then the rate for the next ten years would be adjusted based upon a specified index, for example the inflation rate. Clearly not understanding the concept of the time value of money, the President said he was keen to have a solution which would make the up front payment seem less "ridiculous" in a few years. Although the President's suggestion also clearly runs afoul of Azerbaijani law, so far no one on his staff is going to challenge a

suggestion made by the President himself. When asked whether the President's suggestion could also include a maximum rate of increase or cap, Presidential Advisor Ali Asadov replied that this would be technically possible, but would require experts to work to conform this to Azerbaijani law. While this could be viewed as further stalling tactics, the invitation for experts from both sides to meet and negotiate a solution is encouraging.

What's Going On Behind the Scenes?

15. (C) The abrupt changes in Azerbaijani "legal interpretation" are clearly influenced by political dynamics that have nothing to do with the NEC discussion. The original lease was signed on March 7 with assurances that all paperwork would be completed within two weeks. On March 13, the U.S. voted against a key Azerbaijani resolution at the UN which resulted in not only a failure to secure the appropriate approvals, but a refusal to take our calls for three months. The Foreign Minister and the head of the President's legal department have told us that if not for this UN vote, we would have long ago had possession of the property. With the deterioration of our bilateral relationship in the spring and summer of 2008, the President's willingness to seek Parliamentary approval for the special terms of the lease disappeared.

16. (C) Similarly, on February 5, Presidential Advisor Asadov told us that all the problems over the lease payment issue had been smoothed over and that the President would use his "executive authority" to approve the lease without

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Parliamentary approval. As we worked out wording for an amendment to the lease, the Azerbaijanis became increasingly concerned about the U.S. role in fostering reconciliation between Turkey and Armenia. As a consequence of these political problems, Asadov informed us on May 19 that the deal was off because of legal objections. Again, a rough patch in our bilateral relationship made the President reconsider his offer of using his executive authority to approve the lease.

17. (C) Is it all political? Not all, but most. The Azerbaijanis view the current lease as a gift to the United States. It was originally promised to Ambassador Derse in fall 2006 as a site for "free." This morphed into a dollar a year, then the minimum lease rate (currently \$9,500/year). The President is not ready to transfer the site to us at a time of political tensions. At the same time, if the political conditions are right, there also has to be a formula that provides the government a fig leaf of an impression that it is obeying its own laws (or something in the spirit of the law). Both this political will and the defensible formula must exist at the same time to move forward. One without the other will not be sufficient. It is certainly true that the goalpost for what is "defensible" has shifted over time. It suggests that the USG should try to move quickly to close the deal when the opportunity arises, or risk having the agreed deal fall apart on the Azeri side.

Where have We Been?

18. (U) Our search officially began in 2000 with a diplomatic note declaring our intention to lease land to build a NEC. Foreigners cannot purchase property in Azerbaijan. From 2003 to 2006, the Embassy worked with OBO to pursue a lease on a privately-owned property known as Alatava. This was abandoned in 2006 when the owner demanded \$50 million, more than double the assessed value. During this same period, the Embassy worked with the State Property Committee to research appropriate government-owned land. Having identified a former machine-building plant, the Minister of Economic

Development withdrew the site without explanation.

¶9. (U) In 2006, again working with the State Property Committee, an OBO/Embassy team selected a derelict film studio. During the approval process, the State Property Committee privatized the land for \$200,000. The new owner offered it to the Embassy for \$35 million, again far in excess of its assessed value.

¶10. (C) Because of these repeated disasters, Ambassador Derse in 2007 appealed for help to the President. With the support of the President's office and the promise of a free site, the OBO/Embassy team identified the Genetics Institute as the site of the new Embassy. After significant design work and lease negotiations, the President withdrew the offer of this site. It is rumored that the President's uncle decided he wanted control of this land.

¶11. (U) Embarrassed by their withdrawal of two offered sites, President Aliyev promised another parcel of State-owned land for free. His Advisor Ali Asadov showed OBO and the Embassy several sites, from which the Trolley Park site was selected. On May 11, 2007, the USG and the Azerbaijani Government signed a Protocol of Intent which spelled out specific terms including a symbolic rent and comportment with the Bilateral Agreement. These terms were incorporated into the lease which was signed on March 7, ¶2008.

What is to Be Done?

¶12. (C) Our experience is that windows of opportunity open and close very quickly on this issue. We must be prepared to act swiftly to close a deal before the goodwill evaporates. The February 5 window was barely open for two months. It is not clear that this June 1 opening is genuine or not. So far, the President and his advisor Asadov have welcomed the proposal for an OBO property acquisition/legal team to visit Baku to iron out a solution based on the President's suggestion of indexing the lease rate on a ten-year cycle, with a defined cap included in the terms.

¶13. (C) The Embassy has specifically asked Asadov to provide a window of dates and the composition of the Azerbaijani negotiating team, in order to plan for these discussions. We propose that OBO prepare a team and available dates so that the Embassy can use this information to solicit availability

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and composition of the Azerbaijani team. To make the visit most productive, we suggest a date after early-September, since August is the traditional vacation time for Baku (and Washington). We look forward to your response. The Embassy greatly appreciates OBO's continuing support in Baku's NEC site acquisition.

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